

Lessons Learned from U.S. Welfare Reform

Robert M. Solow¹

Prisme N°2
November 2003

¹ Robert Solow is Institute Professor emeritus of economics at the Massachusetts Institute of Technology (MIT). In 1987, he was awarded the Nobel Memorial Prize in Economics for his contributions to economic growth theory. A former president of the American Academy of Sciences and of the Econometrics Society, he is a visiting scholar at the Russell Sage Foundation. Robert Solow is the president of the Cournot Centre for Economic Studies.

Summary

The 1996 U.S. Welfare Reform Act concentrates, almost solely, on getting people to work and off socially assisted programs. The reform has produced changes in the structure of benefits, introduced time limits, strengthened requirements for mandatory participation in work-related activities and changed various administrative procedures. The implementation of this federal Act has been largely left to the discretion of the individual states.

The law has been in effect for seven years and is up for reauthorization. It is thus time to assess its mechanisms and outcomes. Welfare reform is responsible for a portion of the increase in beneficiaries' work and earnings. Most evidence from econometric studies points in this direction. Many of these studies, however, overlook the fact that employment and the demand for welfare assistance are heavily influenced by macroeconomic factors among other things.

In this booklet, Robert Solow evaluates these analyses and provides direction for future reforms.

In 1996, the U.S. Congress voted, and President Clinton signed, a landmark welfare reform act. It was a highly controversial decision for several reasons, not least because it marked the end of any Federal guarantee of universal public assistance to the poor. The 1996 Act is about to expire, and Congress is now debating proposed changes before voting to reauthorize it. There is still controversy about what to change and what to keep. Many of the details are specific to the American context and need have no relevance for Europeans who are considering reforming their own social-assistance systems. But some of the 1996 reforms were generic, and the outcomes may provide useful background for welfare reform in Europe. My goal in this paper is to provide some guidance along that path.

There are (at least) two important respects in which the American context differs significantly from the European one. The first is organizational. The U.S. is a genuinely federal system. Many of the ideas, initiatives and practices of the welfare system have their origin in the states and are carried out by state bureaucracies. A substantial part of the cost of welfare is borne by the states. In recent years, the federal government has tended to hand off more and more functions to the states, sometimes with a financial contribution and sometimes without. Such a devolution was part of the 1996 Act, with the federal share coming as a block grant to each state, and only limited federal requirements.

The second difference that I want to mention has to do with the foundations of welfare policy. What are the motivations that induce societies to have a welfare system in the first place? And what goals is welfare policy supposed to accomplish? There are two obvious candidates. The first one is to achieve greater equality by improving the lives of some or all poor people, even if this improvement has to be financed by taxing and transferring the incomes of the better-off. The second one involves reducing or eliminating the incidence of poverty, meaning the inability to achieve the minimum standard of living regarded by the society as tolerable. These are related, of course, but not the same; one focuses on relative incomes and the other on absolute incomes.

Neither of these motives adequately captures what the American welfare reform is about. There is little interest in the U.S. in redistributive policy intended primarily to diminish existing inequality. A little more surprisingly, the welfare-reform

discussion in the U.S. is not really about the reduction of absolute poverty either (although there once was a "War on Poverty"). When the question arises, as it does, typical political responses are usually vague references to the long run. The possible immediate effect of an increase in poverty is not a strong argument against a proposed provision in the welfare system in the U.S.; child poverty is a partial exception and does carry some weight in public and Congressional rhetoric, though not much in action.

So what *is* welfare reform about? The emphasis is mostly on employment, almost for its own sake. The work ethic is very strong and unforgiving: middle-class Americans think that living on "government hand-outs" is a morally repugnant state (except perhaps for the physically or mentally disabled). Women on welfare – they are almost all women – feel this stigma themselves, and they internalize it. Knowing that others look down on them, they look down on themselves. This is just one aspect of the individualism that pervades American society. In consequence, welfare policy has come to be judged mainly on its success in moving welfare recipients into jobs. But the employment history of former welfare recipients (not to mention potential future recipients) is often unknown; thus, by default, the criterion for success becomes simple reduction of the welfare caseload.

This set of attitudes distorts the American debate on welfare policy in a way that may not apply to Europeans. The American discussion tends to rule out simultaneous (or even serial) dependence on work *and* welfare as a viable permanent pattern for some members of society. Thus, one provision of the 1996 Act limited every welfare recipient to a lifetime total of 60 months of benefits. In operation, this time limit was not so straightforward; I will come back to it.

There is one other important aspect of the American discussion of welfare policy that may have echoes in some parts of Europe, but not in others. Most welfare recipients in the U.S. are single mothers, sometimes very young and disproportionately African-American. It is not surprising then that debate about welfare policy gets enmeshed with attitudes toward race, sex and illegitimacy, topics not generally associated with rational social policy. One consequence is that attempts to promote marriage and reduce non-marital births find their way into welfare legislation. But the whole debate is affected, either as text or as subtext.

The two major social-policy provisions of the 1996 Act were (a) a work requirement for welfare recipients and (b) the cumulative time limit already mentioned. Under (a), at least half of all recipients in 2002 and after were required to be working or enrolled in certain other activities designed to improve their employability. "Work" was defined to require 30 hours per week for those with no children under age six, at least 20 of which had to be devoted to actual work rather than education or training. (The requirements for parents with a child under age six were weaker.) States were given considerable leeway in the definition and design of these work-preparation components of the programs. In effect, moreover, the law allowed states to count any reduction in caseloads as an offset to the work requirement. This proved to be a significant escape hatch, and it plays an important role in current debates over reauthorization.

Under (b), as mentioned, the legislation limited any welfare recipient to at most 60 months of benefits cumulated over a lifetime. Welfare could not be "a way of life." For the use of federal funds, states were allowed to set shorter limits but not longer ones. They could, however, exempt up to 20 percent of their caseloads from this requirement, and they could allow longer limits if financed entirely from state funds.

Between them, these two provisions were to mark "the end of welfare as we knew it." As you might expect, then, the "success" of the 1996 Act has been discussed in the political arena mainly in terms of the evolution of caseloads. It is an easily available measure, and, although it provides no information about the number of successful transitions to jobs, it does say something about the speed with which welfare as we knew it is being made to disappear. Unfortunately — for the careful social scientist, though not for the careless politician — it is not clear exactly what the caseload figures are trying to say; and they certainly do not indicate how many of those who have left the welfare rolls are in jobs and at what wages.

The striking fact is that the aggregate welfare caseload at the end of 2001 had fallen by almost 60 percent from its previous peak value. That sounds like a clear verdict. But there are three reasons why any simplistic interpretation is risky. First, caseload reduction began in 1994, two years *before* the passage of the Act. It is conceivable that the change in public attitudes that led to welfare reform was already visible enough in 1994 to affect the behavior of the welfare population, actual and potential. That seems a

little implausible, however, and certainly cannot be taken for granted. It is probably more relevant that many states had launched experimental welfare-to-work initiatives in the early 1990s, some of which had experienced modest success in reducing recourse to the welfare system. (I will have more to say about these later.)

Second, both the peak caseload in 1994 and the 1996 Act came just as the boom of the 1990s was entering its most hectic phase. The number of welfare cases would surely have decreased without legislation. In all, between 1994 and 2000, 17.5 million net jobs were created. Non-farm employment rose by a little over 15 percent, an average increase of 2.4 percent per year. A part of the drop in caseloads has to be attributed to sheer prosperity and demand-pull in the labor market; it is not obvious how big that part should be and how much is left to be accounted for by reform legislation.

Third, there was an unusually sharp rise in caseloads between 1990 and 1994; it is possible that part of the post-1994 reduction was an unwinding of that earlier anomaly. There too, the quantitative interpretation cannot be read from the gross figures and needs to be estimated by whatever research methods can be brought to bear.

There has been an enormous amount of econometric research aimed at explaining variations in welfare caseloads in terms of basic economic variables; if that can be done, it implies an estimate of the specific effect of the 1996 Act on the course of caseloads after 1996. An important advantage of the U.S. economy as a laboratory for this kind of research is the possibility of extracting information from both interstate and intertemporal variations in caseloads and other economic variables (like employment). Anyone wishing an introduction to this research will find an excellent one in the clear and comprehensive survey by Rebecca M. Blank: "Evaluating Welfare Reform in the United States"².

It is a hard question, especially because other policy actions were occurring along with welfare reform, particularly changes in the Earned Income Tax Credit³, and they also changed work incentives. Another complicating factor is hard to capture

² See the *Journal of Economic Literature*, December 2002, pp. 1105-1166.

³ This is a federal income tax credit for low-income workers who are eligible for and claim the credit. The credit reduces the amount of tax an individual owes, and may be returned in the form of a refund.

in research: the effect of a particular policy often depends substantially on informal details of administration by local civil servants. One sees this in U.S.-based research because state bureaucracies have a lot of independence even though they are in principle subject to the same formal rules.

Research results differ depending on the data and methods used by each study. They are not seriously contradictory, however. Caseloads are clearly sensitive to both macroeconomic conditions and policy actions. It is a little disconcerting, however, that the degree of sensitivity seems to vary over time, before and after 1996 for example. This means that extrapolation to future policy actions entails some risk. Nevertheless, it is a reasonable conclusion that the 1996 Act was responsible for something between a third and a half of the dramatic fall in caseloads after 1996.

The research that has been reported so far has not been able to make use of the data arising from the fairly short recession and much longer period of relative stagnation that have characterized the U.S. economy since 2001. Once the data has been taken into account, the margin of error may narrow. The aggregate caseload continued to fall through 2002, though slowly; the macroeconomy may be a little less significant and the Act a little more significant than earlier estimates had suggested. We can be pretty sure, however, that the policy has had a substantial effect on caseloads, but that the claims of politically motivated enthusiasts are subject to the usual significant discount.

In the U.S. context, a principled evaluation of welfare reform should depend on what happens to former welfare recipients and potential future welfare recipients, and most especially on their labor-market experience. On that point, very little is known. Even those who leave the welfare rolls for jobs may lose them soon afterwards without returning to welfare. Unfortunately, there is no nationwide system for tracking the employment (and other) status of welfare-leavers after they have left the system. There are, however, some fragmentary research studies.

Rebecca Blank points out that single mothers with children under the age of 18 increased their labor-force participation rate substantially in the mid-1990s. The rise began in 1993-94, but accelerated sharply after 1995. She reports other scattered bits of evidence of the increased work effort by women currently and recently on welfare. She

notices too, however, that there were other influences besides welfare reform working in the same direction at that time. And there is always the ambiguity created by the fact that the strong labor market of the late 1990s would have siphoned many women off welfare even in the absence of legislation.

I will mention the results of one study, just to give the flavor of what has been done: "Income and Program Participation Among Early TANF Recipients: The Evidence from New Jersey, Washington and Wisconsin," by Maria Cancian *et al.*⁴ (TANF stands for Temporary Assistance to Needy Families, the name given in 1996 to the welfare system that replaced the old AFDC, or Aid to Families with Dependent Children.)

It happens that these three states, though they differ in terms of social and economic characteristics, and in the ethnic and other composition of their client populations, have tracked substantial samples of current and former welfare participants (about 2000 in New Jersey, 3000 in Washington and Wisconsin). One problem for the researchers is to compile comparable answers to interesting questions. This is largely due to the states' varying methods: they draw on different mixes of administrative data and answers to differently phrased survey questions, and cover slightly different time periods between 1999-2001. One lesson for any European country that wants to understand the consequences of its own policy actions is the importance of setting up a uniform system for tracking and acquiring data about a well-designed sample of those who pass through the welfare apparatus (and also, please remember, a demographically reasonable control group or comparison group).

Here is a sample of the conclusions that emerged from the experience of these three states after welfare reform. In all three, the fraction of the sample that had at least some earnings and no TANF payments rose over the three-year period to 58 percent in Wisconsin (which seems to have provided the most extensive support apparatus for welfare-leavers), 44 percent in Washington and 40 percent in New Jersey. (This says nothing about the amount of earnings.) The fraction with neither earnings nor TANF also rose over time to about 30 percent in Washington, a little more than that in New Jersey and a little less in Wisconsin. (The subgroups that decreased were those with both earnings and TANF, which were very small, and those remaining on TANF with no

⁴ Published in *Focus*, Summer 2003, by the Institute for Research on Poverty of the University of Wisconsin.

earnings.)

There are obvious complications in interpreting these data. The survey provides some figures on income from a variety of sources in addition to TANF payments and earnings (for example, food stamps, the earnings of a spouse or partner, other transfers). Mean income from all sources seems to have increased for women, but with wide dispersion. Some are clearly worse off than they were before the reform. And this, of course, was a period of extraordinary national prosperity.

The researchers make an interesting estimate of the probability of being employed and off welfare in the second year after the start of the reform program for each state and for various demographic subgroups. For a woman aged 20-29, white, with a high-school education, never married, with two children and the youngest under age three, and some work experience in the two years before entry into TANF, the probability is close to one-half in New Jersey and Washington, and 80 percent in Wisconsin. But that is a favorable case: the proportions drop to one-third in the first two states and two-thirds in Wisconsin for those with less than a high-school education. (The proportion of all welfare clients without a high-school degree is 39 percent in New Jersey, 21 percent in Washington and 46 percent in Wisconsin.) It is a sure thing that these projected probabilities would be less favorable in a period with a softer labor market. These estimates are consistent with other studies of welfare-leavers⁵. There is no assurance from these studies that the 1996 reform succeeded in moving any large number of welfare families into a viable life based on earnings from employment, even under very favorable macroeconomic conditions. Cancian *et al.* conclude that "the challenge of designing programs that can move single-parent families from difficult circumstances to modest levels of economic success remains unresolved."

A rounded assessment of the success of welfare reform will depend ultimately on the extent to which it moves the relevant population out of poverty, at least absolute poverty. Perhaps something, but not much, can be said for a policy that moves a fraction of the welfare population into jobs, but leaves them worse off than before and forgets the remaining fraction altogether. Only the punitive-minded would be satisfied with that

⁵ See, for instance, Pamela Loprest, *How Are Families that Left Welfare Doing?*, Assessing the New Federalism Project, Urban Institute, Washington, 2001.

outcome. Blank surveys the available studies.

The three-state study by Cancian *et al.* shows that poverty rates decreased in all three state samples during the years covered. (Interestingly, the fraction with incomes less than half the poverty line increased slightly in Washington and Wisconsin, but this was more than offset by the fall in the fraction between half the poverty line and the line itself.) Not much can be inferred from this fact. These were boom years, after all, for reasons that had nothing to do with welfare reforms. And there is no explicit comparison group in the study, though surely poverty rates must have fallen in the non-TANF population.

For the U.S., the consequences of the particular 1996 legislation are naturally of special interest. For other countries contemplating their own welfare-reform decisions, there is an equally interesting body of research that studies the effects of state-designed and state-operated welfare-to-work programs in the years just before 1996. Because these experiments were not the result of national legislation, they could be designed with random-assignment control groups. Much of this work was pioneered by the Manpower Demonstration Research Corporation⁶.

Here is a bird's-eye view of the general conclusions to be drawn from this extensive and excellent work, as they seem to me. Welfare-to-work schemes more often than not generated statistically significant favorable differences between experimentals and controls: those in the program were more frequently employed, and often at higher wage rates, than the controls. But the differences were usually quite small, and often not enough to compensate for the loss of welfare payments. Those in the programs may not have been better off for the experience, especially considering that there are child-care and other costs associated with working.

It is possible that the long-run gains from work experience will be substantial and long-lasting enough so that the welfare-to-work experience will create a clear lifetime gain for those involved. One of the truly important aspects of the MDRC studies is that follow-up data-collection interviews with experimentals and controls were usually

⁶ For an overview, see Judith Gueron and Mark Pauly, *From Welfare to Work*, Russell Sage Foundation, New York 1991, and Gordon Berlin, *Encouraging Work, Reducing Poverty: The Impact of Work Incentive Programs*, MDRC, New York, 2001.

continued for several years after experimentals had left the program. The results varied: in some cases, the favorable program effect seemed to attenuate after a couple of years, while in others, it persisted and sometimes appeared to widen. The important fact is that the programs do improve employment and earning prospects for those involved, but definitely not dramatically.

A second general conclusion is interesting and provocative, and not yet fully understood. Most of the state welfare-to-work programs included a "work-first" option and a "human-capital" option. In the first case, the initial and main emphasis was on an organized job search, the details of job-readiness and, if all else failed, some sort of public or semi-public employment experience. The idea was to get the welfare recipient into some form of paid employment as quickly as possible. In the second option, the initial emphasis was on some sort of educational supplementation, usually at a fairly low level; many welfare recipients had not completed secondary school. The idea, of course, was to improve their later employability. Programs had some routine for selecting and changing these options.

It is perhaps surprising that the work-first participants seem on the whole to have had better success in the job market than those exposed initially to an educational experience. There are several possible interpretations of this result. It may only mean that those particular educational supplements were generally inadequate, providing little or nothing in the way of improved employability. Or it may mean that work experience, or even just job-seeking experience, adds more to employability and earning power than the educational option. Or alternatively, although the work-first advantage seemed to persist over the follow-up period, it is possible that still further down the road the advantage of the educational option will show itself. But that is just optimism as far as the current evidence is concerned.

More recent experiments suggest a further generalization (Berlin, 2001). What they have in common is that those experimental subjects, all drawn from the welfare rolls, who found jobs and worked at them for a substantial number of hours per week (say 35), were provided with large wage supplements, generally enough to lift them above the conventional poverty line. They also had access to health care, childcare and similar services. The results were very promising; not only were labor-market outcomes

favorable, but so also were self-reported family and behavioral tendencies. These more expensive programs, which provide powerful financial incentives, apparently lead to considerably deeper changes in the well-being of participants.

There is a genuine uncertainty about all such experimental results: one does not know if they could be scaled up successfully to the national level and made universal. To take an obvious difficulty, they usually require skilled and dedicated administrators, a scarce resource. Outcomes may depend on the quality of the support staff. A less obvious uncertainty is the "displacement" issue. When welfare recipients in substantial numbers make successful transitions to jobs, how much represents a net increase in unskilled employment, and how much represents the displacement of formerly employed (non-welfare) workers? There is no convincing answer to that question, and it is hard to see how a practical test could be constructed. The key here is to realize that the total amount of employment, including unskilled employment, is in large part a macroeconomic fact. The creation of an incremental supply of unskilled workers has to be accompanied by appropriate demand-side policies, or else the net burden may simply fall on the working poor.

A brief tabular survey of the advantages and disadvantages of alternative welfare-to-work policies can be found in a paper by Jeffrey Grogger, Lynn Karoly and Jacob Alex Klerman, "Conflicting Benefits: Trade-Offs in Welfare Reform"⁷; it includes a reference to a full report.

The current Congressional debate about possible changes in the 1996 Act centers on the definition of the work requirement. (There are also issues about the funding of childcare and about the promotion of marriage that are of less interest to Europeans.) One controversial question is the extent to which education and training activities should count as work; apparently less controversial is a proposal to increase the fraction of the caseload each state must direct to work activities from 50 percent to 70 percent. A third issue is the "caseload reduction credit" mentioned earlier: to what extent should reductions in caseloads count as an offset to the requirement that welfare recipients engage in work activities? Finally, there is debate about the number of hours per week recipients must work to count as "engaged in work

⁷ Published in the *Rand Review*, vol. 26, No. 3, Fall 2000, by the Rand Corporation.

activities." The current law requires 30 hours, at least 20 of which must be actual work (as against education or training). The Bush administration has proposed increasing those numbers to 40 and 24, as well as narrowing the list of activities that can be counted as "work." With minor exceptions, controversy about these matters is along party lines. One cannot guess what compromises may emerge.

What might a European interested in these matters learn from the American experience with welfare reform? Here are just a few broad conclusions.

- (1) One needs to be clear about goals: reducing the incidence of welfare, increasing employment, diminishing inequality, improving the lives of the unskilled, or some combination of these.
- (2) Any policy initiatives should be accompanied from the very beginning by carefully designed evaluation research, including control or comparison groups. There is no other way to distinguish the effects of policy from good or bad coincidences.
- (3) Dramatic effects are very unlikely. It is better to start with the expectation that success consists of small incremental improvements in the status of the welfare population, however that status is to be measured.
- (4) The welfare population responds to incentives, like anyone else. If it is desired to move part of the welfare population into the world of work, one needs policies that are complementary to work and not substitutes for work. The Earned Income Tax Credit is the important example in the U.S.⁸

⁸ On this point, see Blank, as well as the note by Robert Haveman, "When Work Alone Is Not Enough," in *La Follette Policy Report*, vol. 13, No. 2, Fall-Winter 2003, published by the Robert M. La Follette School of Public Affairs, University of Wisconsin.

- (5) My own view is that the absolute time limit is one of the major mistakes in U.S. policy. (In practice, some states find ways to circumvent the federal five-year limit because they find it counter-productive.) There may be a part of the population that can have reasonable lives only by combining welfare with work. It is perverse to rule this out.